Appendix B

Industry Overview

THE PRODUCE INDUSTRY

The produce industry is made up of several small industries. Its products are commodities—similar to the beef, poultry, pork, and dairy industries. When price is the main difference between two similar products, competitors lower their prices in order to compete with each other. As the price falls, the profit margins fall as well. As profits decrease, the funds available for promotion, marketing, and advertising diminish. Unless one product is differentiated from another, price and perceived value determine what makes one product more appealing than another.

Higher profit margins can be achieved once "value" has been added. For example, wheat (a commodity) can be made into any one of 100 different types of value-added cereals that are puffed, flaked, rolled, or shredded and to which fruits, nuts, sugar, flavors, colors, marshmallows, toys, fiber, vitamins, minerals, and/or phytochemicals may be added. When a manufacturer develops a unique product that is desired by consumers, higher profit margins can be achieved.

Overall profit margins in the produce industry, which is still largely a commodity industry, are relatively small compared with those of the processed foods industry. And in contrast to other commodity businesses, the produce industry has not been subsidized by the Federal Government.

FOOD MARKETING ORDERS

A food marketing order (sometimes known as a checkoff program) is one in which the growers of a particular commodity assess themselves a specific fee, depending on the shipping unit or value of the product, and the revenues generated are pooled into a fund. For example, 25 cents per box of apples is collected from all apple growers in Washington State to go into a pool of funds at the Washington Apple Commission to promote Washington apples nationally and internationally. These marketing orders can be organized at the State or Federal level and may have different purposes. Most revenues are used for product grading and standardization, product research, the opening of new markets, and marketing and promotion of the agricultural product.

In the case of the dairy or beef industry, competitors have agreed to work together to pool their funds and mutually promote their generic commodities. This collaboration is fairly easy because dairy farmers produce milk by volume, and an assessment on one product by volume would therefore be equitable. A similar situation exists within the beef industry.

In the produce industry, there are marketing orders for some vegetables and most major fruits. In fact, there are nearly 300 different marketing organizations. For example, there exists a California Tomato Board, a Florida Tomato Committee, a California Strawberry Commission, a California Prune Board, and a California Table Grape Commission, each representing different commodities and, in some cases, different States. As another example, there is a National Potato Board, a Maine Potato Board, an Idaho Potato Board, and a Washington State Potato Board; Idaho, Maine, and Washington State are all competing for a share of the consumer potato market, and the National Potato Board represents all potato growers and works to encourage Americans to eat more potatoes.

A NATIONAL PRODUCE MARKETING ORDER

Until the 5 A Day Program, the produce industry had never successfully promoted the whole vegetable and fruit category of commodities with one message. Specific commodities—such as grapes, lettuce, tomatoes, or tree fruit—had been promoted on an individual basis. Discussions among industry leaders about the possibility of a national marketing order for vegetables and fruit as an entire category began to occur with the advent of the 5 A Day Program. A national marketing order, which would require an assessment on all vegetables and fruit either produced or sold in the marketplace, could help generate millions of dollars that could then be used to conduct advertising and nutrition education about 5 A Day.

Several produce industry leaders met in February 1996 to discuss the possibility of a national marketing order for vegetables and fruit. Participants were primarily commodity boards and association representatives. They agreed that although a checkoff program for all vegetables and fruit could prove beneficial, generating millions of dollars as a pooled fund, such a system would be difficult to implement.

Discussion centered primarily on how to make a national checkoff system equitable among the more than 350 different produce items in distribution. As an example, an assessment by weight (5 cents for every pound sold) would be difficult because some produce items weigh more than others (e.g., watermelon versus raspberries).

In addition, profit margins among different produce items may differ significantly, based on supply and demand. Depending on supply and demand, profit margins on even a single produce item can vary significantly over a given year (one might be 20 cents per box, whereas another might be 5 cents per box). In obtaining a fair agreement, it would be difficult to assess products equal in weight but possessing largely different profit margins. A 20-cents-per-box assessment might be more than the profit margin for a particular product; consequently, the farmer would be selling that product at a loss.

Even if it were possible to find an equitable way of assessing all vegetables and fruit, the collection of funds would be difficult. If there were one port, as an example, through which all the produce consumed in this country entered, it might be possible to collect the 20-cents-per-box or 5-cents-per-pound assessment. But the distribution system for these highly perishable items is so vast and varied that it does not offer a consistent point at which these assessments could be collected. And if money were collected at some points and not others, the assessment would no longer be equitable.

If everybody is benefiting from national advertising and nutrition education, yet only some of the farmers are paying for it, then some farmers are paying to advertise their competition's product. The issue is not whether a national checkoff system would be useful but rather how to make it equitable enough so that everyone would participate and how to collect the funds to ensure that all were paying their fair share. And some growers are suing commodity boards because they would rather keep the money or use it for their own advertising.

Thus, it was concluded that implementation of fair and equitable checkoff systems to raise funds for the 5 A Day Program is not currently possible in this country. As a result, the Produce for Better Health Foundation (PBH), which manages the private sector of the public/private partnership, relies on voluntary donations from the vegetable and fruit industry and others to conduct its marketing and nutrition education programs.

FOOD PYRAMIDS

Even though the Food Guide Pyramid is a guide for Americans (see Figure 1) regarding the amount of food to consume in their diets, it is useful to assess the food groups in the Food Guide Pyramid in terms of their disease-preventive capacity (See Figure 2). Vegetables and fruit are more important to disease prevention than any other food group by far.

The problem, however, is that marketing dollar allocations for each of the food groups in the pyramid are not equal (See Figure 3). Marketing dollars are concentrated on those "added-value" foods that have been processed and packaged attractively. Compare McDonald's total advertising/marketing expenditures (more than $1 billion annually) or the Coca-Cola Company's advertising/marketing expenditures for all products ($770 million annually), to the $1.75 million budget of PBH or the $11 million for the California Table Grape Commission, one of the strongest commodity groups in the produce industry.

Unfortunately, the limited marketing dollars within the produce industry are often targeted at supermarket chains or food-service restaurant chains and not as much toward consumers, because these supermarkets and restaurants are the gatekeepers. If growers cannot get their products onto the supermarket shelf or into the restaurant, then they stand little chance of reaching the consumer.

SUPERMARKET INDUSTRY

The U.S. supermarket industry is extremely competitive. Nearly 350 supermarket chains represent more than 35,000 stores. There are also independent grocers who are not part of a chain but own anywhere from 1 to 10 stores. These are generally serviced by wholesalers such as SUPERVALU and Fleming. A typical supermarket produce department may have anywhere from 15,000 to 20,000 customers in any given week. Supermarkets also serve as anchors in communities, the one location most people visit at least occasionally. Supermarkets are powerful partners for spreading the 5 A Day message to consumers.

Six important factors in the supermarket industry must be understood relative to the 5 A Day effort. Some of these factors are useful for 5 A Day; others present challenges.

Consolidation Is Occurring

First, consolidation has occurred since the 5 A Day Program began in 1991. As an example, Safeway, based in Pleasanton, California, announced in April 1997 that it would acquire The Vons Company. That merger made Safeway the second-largest supermarket chain in North America with

Figure 1. Food Guide Pyramid

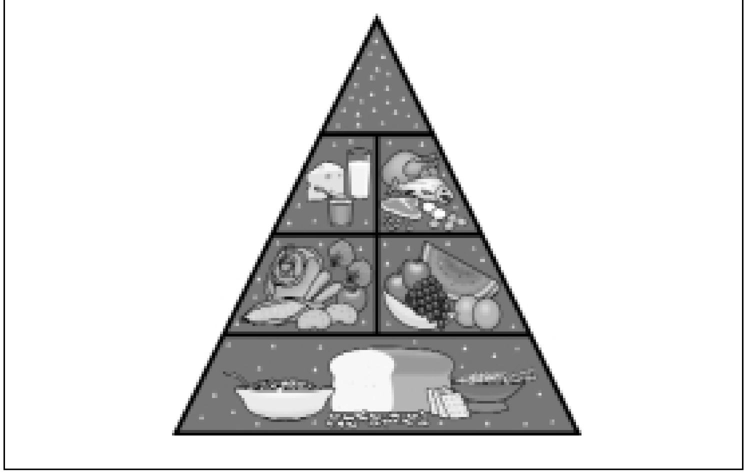


Figure 2. Health Benefits

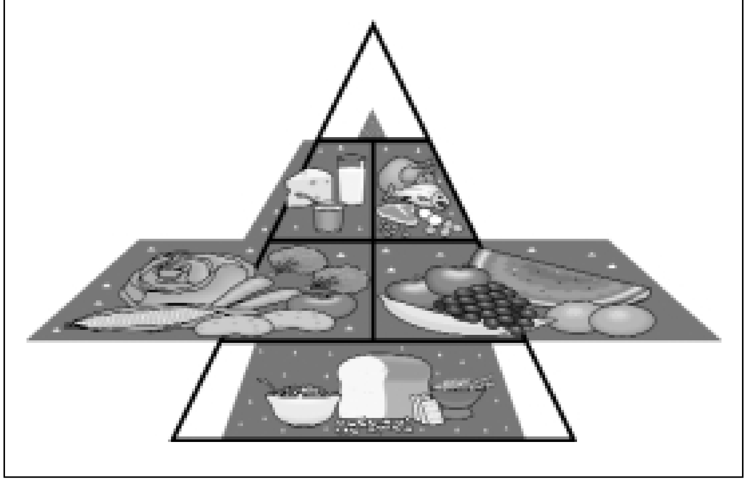
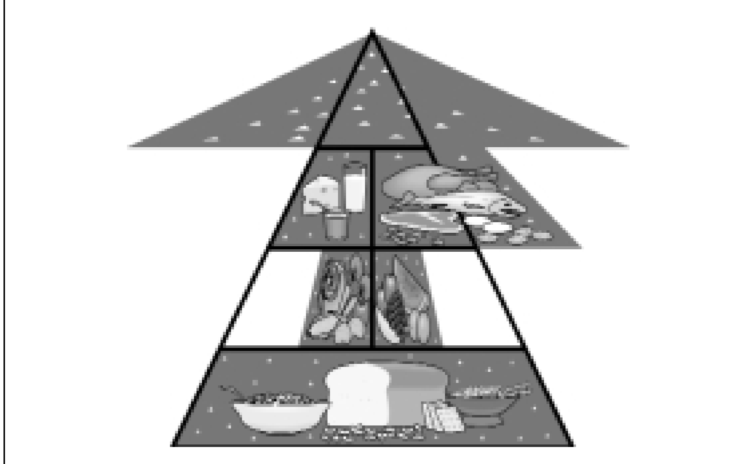


Figure 3. Marketing Dollars



1,378 stores. In August 1998, Albertson's, Inc. (based in Boise, Idaho), said it would pay $8.3 billion for the Salt Lake City-based American Stores Company. That deal will create the largest supermarket company in North America—2,470 stores in 37 States with annual revenue in excess of $36 billion. The top five chains today account for about 40 percent of total sales. When companies are more concerned about mergers and takeovers, they sometimes forget about important long-term programs like 5 A Day.

Produce Is Profitable

A second important factor is that the produce department is the most profitable area for the supermarket. Profit margins on produce alone average 44.1 percent (Bill Communications, 1997). The only department with greater margins—52.3 percent—is the in-store bakery. The percentage of total supermarket sales through bakeries, however, is far less than that from produce (3.57 percent of supermarket sales for bakeries versus 10.89 percent for produce), making produce the most profitable area of the store. In addition, high-quality produce is one of the top reasons consumers choose a primary grocery store. Produce is cited as most important by 90 percent of customers. A clean, neat store (88 percent) ranks second, and high-quality meat (84 percent) ranks third (Food Marketing Institute, 1998a). This trend provides an incentive for the retailer to promote vegetables and fruit.

Cross-Promotions Are Attractive

Produce takes up an average 12.7 percent of the supermarket floor space (Food Marketing Institute, 1998b). It is also the highest impulse-purchase area of the supermarket; that is, half of all produce purchase decisions are not made until the consumer is in the department. Brand manufacturers like to have their products featured next to produce because the chance of an impulse purchase is greater. For example, if the shortcake is sitting next to the strawberries, the shortcake is more likely to be purchased than if it were elsewhere in the supermarket. Retailers state that sales of an item can easily double when it is placed in the produce department. Therefore, PBH has recently begun to work with other manufacturers of complementary products, such as salad dressings, yogurt, mustard, and peanut butter, to cross-promote with vegetables and fruit.

Slotting Allowances Are Required

Because supermarkets are making small overall profit margins (0.5 to 2 percent) and are looking for ways to reduce costs or make money, they often will ask for slotting allowances (payment to supermarkets for shelf placement) from manufacturers for end-aisle displaying of their products or for other prime locations. In some cases, nearly 50 percent of supermarket income comes from slotting allowances and other manufacturer-supported funds. Even produce growers are asked for slotting allowances for product placement, making even fewer funds available to growers for marketing their products or for supporting the 5 A Day Program.

Supermarkets Are Financially Driven

Because supermarkets are trying to make as much profit as possible, often they will not reduce the price of a particular produce item if production is up in order to encourage greater sales, which presumably means greater consumption. With a highly perishable item such as produce, the production volume of which varies with weather and seasonal factors, it is helpful when retailers can reduce the price when there is an abundance of low-cost, in-season produce to help increase their sales volume and the consumption by consumers.

For example, if there is a surplus of apples, the supermarket could lower the price to increase apple sales, and presumably consumption. Just a few years ago, retailers would do this for their apple suppliers. Now, when the price of apples falls because of greater supply, some retailers do not pass those savings along to the consumer. Before, retailers and growers alike probably were not making more money, but at least they were selling more apples. Now, unless the retailer is going to make more money, they are not as likely to lower the price to help sell more produce and increase consumption. In some cases, unfortunately, the retailer may lose money when the price is lowered, despite moving a higher volume of product through the store, because labor costs to restock the produce also are greater. This type of philosophy has changed the produce business in the past 10 years, to the detriment of the producer and the consumer.

Restaurant Industry Competition Is Increasing

Finally, another key trend is the increasing competition posed by restaurants and fast-food chains to the supermarkets. Nearly 50 percent of the consumer food dollar is spent eating away from home, partly out of a desire for convenience. When adjusted for inflation, consumers were spending about $2 less per week in supermarkets in 1998 than they were in 1994 (Food Marketing Institute, 1998a). This indicates that the 5 A Day Program should be introduced in restaurants and other away-from-home dining facilities where consumers eat.

FOOD-SERVICE INDUSTRY

The food-service industry is more diverse than the supermarket industry. Food-service operators are classified into two groups—commercial and noncommercial. Commercial operators include fine-dining establishments, family restaurants, and quick-service restaurants. Noncommercial operators include food service at schools; day-care centers; colleges; health care centers; businesses, industry, the military, and correctional facilities; transportation companies (e.g., airlines, trains); and contract management companies.

The sixth consecutive year of real growth in the restaurant industry was reached in 1997 (National Restaurant Association, 1998). The number of food-service locations in the United States is nearly 800,000, compared to 35,000 major supermarkets, making food service (in all of its varieties) a much more complex effort to undertake (National Restaurant Association, 1998).

The typical person 8 years or older consumed an average of 4.1 meals per week away from home in 1996, up from 3.8 meals per week in 1991 (National Restaurant Association, 1996). Thus, approximately 49 billion commercially prepared meals were ordered in 1996, compared with 38.4 billion in 1981 (National Restaurant Association, 1996).

Of all the weekly meals consumed in 1996, nearly 69 percent were prepared at home, almost 20 percent were prepared at a restaurant or school or work cafeteria, and nearly 12 percent of all meals were skipped altogether (National Restaurant Association, 1996).

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